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PROPERTY INTERESTS WITHIN NEBRASKA INHERITANCE TAX PROVISIONS

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The 1901 Nebraska Legislature in enacting the inheritance tax, following the provisions of most other states, subjected to this tax not only property passing by will or intestacy or transferred in contemplation of death but also all lifetime transfers "intended to take effect in possession or enjoyment after death" or under which, and as a rseult of death, "any person or body corporate shall become beneficially entitled in possession or expectation to any property or income thereof."[1] Although the statute exists in substantially the same form today,[2] its scope is largely undetermined by Nebraska Supreme Court decisions.

Based upon the body of state law, the Federal Estate Tax, when first enacted in 1916, included a tax upon "transfers in contemplation of or intended to take effect in possession or enjoyment at or after death. . . ."[3] The federal statute provided a tax upon transfers taking effect "at or after" death while the Nebraska statute taxed those taking effect only "after" death. The federal statute contained no provision comparable to the Nebraska clause imposing a tax on transfers under which one becomes beneficially entitled in possession or expectation to any property by reason of death.

The federal statute has been construed and amended many times since its original enactment. This article considers the comparative development of the federal and Nebraska statutes and the relevance of the present federal law in applying the present Nebraska statute.

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1 NEB. REV. STAT. §117-1 (1901) (citation for historical purposes only): "All property, real, personal and mixed which shall pass by will or by the intestate laws of this state from any person who may die seized or possessed of the same while a resident of this state, or, if decedent was not a resident of this state at the time of his death, which property or any part thereof shall be within this state, or any interest therein or income therefrom, which shall be transferred by deed, grant, sale, or gift made in contemplation of the death of the grantor, or barainor or intended to take effect, in possession or enjoyment after such death, to any person or persons or to any body politic or corporate, in trust or otherwise, or by reason thereof any person or body corporate shall become beneficially entitled in possession or expectation to any property or income thereof, shall be and is subject to a tax."

2 NEB. REV. STAT. §77-2002(1)(b) & (c) (Reissue 1958).

3 Revenue Act of 1916 § 202(b).

I. RETAINED LIFE INTEREST—ACTUAL OR CONTINGENT

One example of the operation of the statute is a transfer in which the transferor retains a life estate, legal or equitable, in the transferred property.[4] This transfer is intended to take effect in "possession or enjoyment" after death, the remaindermen acquiring possession or enjoyment only after the transferor's death. The Nebraska court has further held that the reservation of income from a trust to be paid to the transferor during his lifetime with distribution to take place to the beneficiaries upon the death of the transferor was within the operation of the statute.[5] These interests are intended to take effect as to possession by some beneficiaries and enjoyment by all beneficiaries upon the death of the settlor.

The Nebraska Supreme Court has also held that a transfer of a life estate to another with the remainder to the other party's heirs or, if none, to children of the transferor was not included within the statute.[6] Possession or enjoyment in no way depended upon the death of the transferor but upon the death of the life tenant. Had the remainder gone to the "heirs" of the transferor rather than the "children" of the transferor, arguably, it might have been included within his estate. It would then have been necessary to survive the transferor to take the remainder, assuming that the life tenant died without heirs.

The problem of retained life estates has posed considerable difficulty for Congress and the United States Supreme Court. In *May v. Heiner*[7], the court held that the original federal statute did not apply to reserved life interests on the theory that the transferor's death obliterated any interest which she might have had, and hence no interest passed from her upon death. The Court interpreted "possession and enjoyment" to refer to the title to the property. The decision was overruled in 1949,[8] but Congress had in 1931 enacted specific legislation taxing retained life interests,[9] which now appears as Section 2036 of the Internal Revenue Code. Nebraska has no similar provision.

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4 *In Re* Estate of Bronzynski, 116 Neb. 196, 216 N.W. 558 (1927).

5 Douglas County v. Kountze, 84 Neb. 506, 121 N.W. 593 (1909).

6 *In Re* Estate of Bronzynski, 116 Neb. 196, 216 N.W. 558 (1927).

7 281 U.S. 238 (1930). The decision was followed per curiam in Burnet v. Northern Trust Co., 283 U.S. 782 (1931); Morsman v. Burnet, 283 U.S. 783 (1931); McCormick v. Burnet, 283 U.S. 784 (1931).

8 Commissioner v. Estate of Church, 335 U.S. 632 (1949).

9 INT. REV. CODE of 1954, § 2036. Congress has further repudiated the 1949 decision by providing that transfers reserving a life estate are not taxable if made prior to 1931.

May v. Heiner[10] presented an additional problem. The decision involved a transfer in trust to a third party for life, then to the transferor for life, with the remainder to the settlor's children. The transferor's life estate was contingent upon his survival of the intervening life tenant. The Court in its opinion did not discuss the effect of the intervening life tenancy, but the problem of inclusion of a secondary life estate can be presented squarely in the event the transferor predeceases the intervening life tenant. Such a situation was presented to the Seventh Circuit Court of Appeals.[11] That Court held such retained secondary life estate to be within the scope of what is now Section 2036 of the Internal Revenue Code of 1954. The United States Supreme Court denied certiorari.[12] This is in accord with the present position of the Commissioner.[13]

Although Nebraska has no provision comparable to Section 2036 it would seem to be contradictory to include a reserved life estate within the "possession or enjoyment" section and exclude a contingent or secondary life estate. To make the inclusion depend upon the life of the intervening life tenant would be fortuitous at best. The Nebraska statute should bring the *remainder* back into the estate as a transfer "intended to take effect in possession or enjoyment after his death" as that would clearly seem to be the decedent's intention. However, the *value* of the intervening life estate should not be so included.

II. USING THE DONOR'S LIFE AS A "MEASURING STICK"

If the transferred property is to be held and the income accumulated until the transferor's death, at which time the property is to be distributed to the beneficiaries, it would seem that the transferor intended the transfer to take effect after his death. Before the enactment of Section 2036, however, the United States Supreme Court held in *Reinecke v. Northern Trust Co.*[14] that trusts terminating five years after the settlor's death were not within the operation of the federal "possession and enjoyment" provisions, since the settlor had disposed of his entire interest in the property. Under the Nebraska statute, despite the settlor's having parted with the entire property, the disposition still appears subject to tax under

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10 281 U.S. 238 (1930).

11 Commissioner v. Nathan's Estate, 159 F.2d 546 (7th Cir. 1947).

12 334 U.S. 843 (1948).

13 Treas. Reg. §20.2036-1(b)(1)(ii) (1961).

14 278 U.S. 339 (1929).

the language "by reason of death, any person shall become beneficially entitled in possession or expectation to any property or income thereof." Similarly, an irrevocable inter vivos trust with the sole power in a completely disinterested trustee to revest the corpus in the settlor could be subject to the inheritance tax.[15]

Another transfer within the literal meaning of the "possession and enjoyment" section occurs when the transferor transfers the property in trust for a period of years with the income accumulated in trust, and possession of the income and principal at the end of the period passing to a third party. When the period of time is obviously longer than the life expectancy of the transferor the transfer seems to be clearly intended to take effect in "possession or enjoyment" after death. However, in a similar situation under the original federal statute where the income was to accumulate for thirty years while the transferor's life expectancy was only sixteen years, the Court ignored the fact that the transfer was obviously not intended to take effect in possession or enjoyment until after death and held such a transfer not within the scope of the statute.[16] The holding was apparently based upon the fact that the transferor had retained no interest in the property transferred. Although such a transfer is obviously intended to take effect after death, as the period of distribution is beyond the life expectancy of the transferor, and is arguably within the broad language used by the Nebraska Supreme Court in *Douglas County v. Kountze*,[17] it would not seem that the property would be returned to the transferor's estate under the Nebraska statute. The transferor retained no interest in the property of the type meant to be reached by the statute and the settlor's own life is in no way employed as a measuring stick. In some situations, the transferor retains the income from property transferred for a period of time, remainder to a third party, with the property passing to the third party in the event of the transferor's death during the prescribed period. If the transferor lives through the period of time and the property passes to the third party before the transferor's death, then nothing is returned to his estate by the operation of the Nebraska statute.

If the transferor dies within the period of retained benefits, the problem becomes one of determining the value of the interests to be included within the transferor's estate. If the retained period was obviously a period of time shorter than the life expectancy of

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[15] Note, *Possession or Enjoyment under* §2036, 43 Neb. L. Rev. 881 (1964).

[16] Shukert v. Allen, 273 U.S. 545 (1927).

[17] 84 Neb. 506, 512, 121 N.W. 593, 596 (1909).

the transferor, the Nebraska statute seems to require only that the value of the interest retained by the transferor should be included and not the value of the property transferred. Section 2036 of the Internal Revenue Code, taxing retained life interests, handles the problem by treating periods of time which do not in fact end before the death of the transferor the same as it would a retained life interest,[18] taxing the entire value of the property transferred in transferor's estate.

A more recent problem in this area has arisen through the use of pension and profit sharing plans. The decedent is often given the power to designate a beneficiary of the amount paid in to the plan in the event of his death prior to the time when he would have received the benefits. In such event the property involved may be includable within the decedent's estate under the statute.[19] The federal cases were split on the federal question prior to the enactment of what is now Section 2039 of the Internal Revenue Code of 1954.[20]

Pennsylvania, under a statute much similar to the Nebraska provision, held the decedent's employer's contributions to a profit sharing fund subject to inheritance tax.[21] The decedent had exercised his right to designate the beneficiary in the event of his death. The court held that the designation of the beneficiary was a transfer intended to take effect in possession or enjoyment only at and after his death. That court made it clear, however, that the transfer itself occurred after death and not when the designation of beneficiary was made.

The Supreme Court of Michigan in *In Re Brackett's Estate*[22] held the designation of a beneficiary of such a plan to be a transfer of an interest to take effect at death and subject to inheritance tax. The Michigan court seemed to conclude, however, that the transfer occurred upon the designation of the beneficiary which took effect upon the death of the transferor.

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[18] INT. REV. CODE of 1954, §2036.

[19] See Estate of Garber v. Commissioner, 271 F.2d 97 (3d Cir. 1959). So long as the decedent can be considered the transferor, his death would certainly seem to cause a shift in possession or enjoyment as a result of a transfer intended to take effect in possession or enjoyment after death.

[20] LOWNDES & KRAMER, FEDERAL ESTATE & GIFT TAXES 207 (2d ed. 1962).

[21] *In Re* Dorsey's Estate, 366 Pa. 557, 79 A.2d 259 (1951).

[22] 342 Mich. 195, 69 N.W.2d 164 (1955).

The Supreme Court of New Jersey has apparently gone a step further in *Cruthers v. Neeld.*[23] The Court held an annuity purchased for the decedent by his employer subject to inheritance tax under the New Jersey statutes which impose a tax upon property transferred "by deed, grant, bargain, sale or gift made in contemplation of the death of the grantor, vendor or donor, or intended to take effect in possession or enjoyment at or after such death."[24] The decedent died before receiving benefits thereunder, and had no right to designate the beneficiary, such right being in the retirement committee. The court stated:[25]

> The instruments in question, we think, are indisputably vehicles designed for the transmission of property in lieu of testamentary disposition, and the transfer accomplished by them is encompassed within the purview of R.S. 54:34-1(c), N.J.S.A., taxing such transactions effective at death.

The Court did not discuss the fact that the decedent made no transfer himself within the meaning of the statute, apparently satisfied that the transfer occurred through the transmission of wealth.

In Re Estate of Dolbeer,[26] the Ohio Court of Appeals held that the proceeds of an insurance policy paid to decedent's widow under a contract whereby the decedent was to forbear from competitive employment were not includable within decedent's estate for Ohio succession tax purposes as a transfer to take effect in possession or enjoyment in the future. The decedent's employer was to pay the premiums, collect the proceeds, and pay them to the wife under the terms of the contract. The court reasoned that the decedent never became the owner of the proceeds nor had any interest in them.

In *O'Donnell v. District of Columbia,*[27] the District of Columbia Tax Court held that a widow's benefits from her deceased husband's compulsory retirement plan were not subject to tax under a similar provision where the deceased had no voice in selecting the beneficiary, made no contributions, and could only defeat the widow's rights by resignation.

The existence of a pension board should not preclude the tax if it could not deny the benefits to the designated beneficiaries.[28]

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[23] 14 N.J. 497, 103 A.2d 153 (1954).

[24] N.J. STAT. ANN. §54:34-1(c) (1960).

[25] Cruthers v. Neeld, 14 N.J. 497, 103 A.2d 153, 158 (1954).

[26] 117 Ohio App. 517, 193 N.E.2d 174 (1962).

[27] CCH INH. EST. & GIFT TAX REP. ¶ 19473 (1963).

[28] Estate of Garber v. Commissioner, 271 F.2d 97 (3d Cir. 1959).

III. TRANSFERS CONTINGENT UPON SURVIVAL

The federal statute now taxes as a transfer taking effect at death property which the transferee can take only by surviving the transferor and in which the decedent has retained a reversionary interest of more than 5% of the value of the property at the time of his death.[29] Transfers contingent on survival of the transferor have been subjected to a long and tortious history, one part of which led to the enactment of Section 2036, reaching retained life interests, discussed above.

As a product of a long line of cases, including minute technical distinctions and reversals of position,[30] the Supreme Court in 1949 decided the landmark *Commissioner v. Estate of Spiegel*[31] and *Commissioner v. Estate of Church*[32] cases. In *Spiegel*, a possibility of reverter arising by operation of law rather than any express reservation, which was apparently worth less than $4,000.00 when computed actuarially, made the entire trust corpus of $1,000,000.00 subject to taxation under the "possession and enjoyment" provisions. *Church* taxed a reversionary interest actuarially worth $0.0003 so as to make the entire corpus of $188,000.00 subject to taxation. The effect of these decisions was immediately changed by the enactment of present Section 2037. At an earlier date under federal law, the "niceties of the art of conveyancing" might have been able to differentiate between legal title or beneficial ownership and transfers by operation of law or express reservation.

The effect of the Nebraska statute is not at all clear in these and a number of related respects. It is probable that in the situation where the transferee has no possession or enjoyment of the property transferred unless he or a third party, usually a life tenant, survives the transferor, the transfer is intended to take effect in possession or enjoyment after death and within the scope of the Nebraska statute. However, when the transferee is already in possession or receiving benefits from the property and the transferor's death merely ripens such possession into absolute ownership, the operation of the statute is not so obvious. As long as the Court would be willing to include "title" within the scope of "possession and enjoyment," such a transfer would be within the statute. It seems, however, that as the transferee has had enjoyment of the

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[29] INT. REV. CODE of 1954, §2037.

[30] LOWNDES & KRAMER, FEDERAL ESTATE & GIFT TAXES 101-104 (2d ed. 1962).

[31] 335 U.S. 701 (1949).

[32] 335 U.S. 632 (1949).

property prior to the transferor's death, only the actuarial value of the decedent's reversionary interest should be included within his estate.[33]

In any event, the issues concerning transfers contingent upon surviving the transferor remain to be litigated under the Nebraska statute. Perhaps, the wisest course to follow, noting the long and difficult federal litigation, would be to seek an amendment of the Nebraska statute along the lines of present Section 2037 of the federal code.

IV. RETAINED POWERS—BENEFICIAL AND NON-BENEFICIAL

This section deals with situations in which the transferor of property retains *some* power with respect to the transferred property. Such a power may be one under which the transferor himself can benefit from the exercise or nonexercise of the power, or one under which the transferor is not affected by the exercise or nonexercise. The retained power situation should be distinguished from the case where the decedent possessed a power over property transferred by another person. Where the decedent is not the transferor of the property, the only provisions subjecting the property to tax are the powers of appointment statutes. The Nebraska inheritance tax statute specifically excludes from taxation all powers of appointment, general or special, exercised or non-exercised.[34] The federal statutes applicable to transfers after 1942 tax the property subject to the power if the holder of the power can benefit himself, his creditors, his estate, or creditors of his estate.[35]

In 1924, Congress added to the estate tax a provision expressly taxing revocable transfers.[36] The federal statute now taxes to the transferor's estate those transfers in which he reserved a power to alter, amend, revoke or terminate which was in existence at his death.[37] The reserved power need not be beneficial, but only a discretionary power.[38] Thus, even the retention of the power to accelerate the enjoyment of the trust property by a person ulti-

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33 NEB. REV. STAT. §77-2001 (Reissue 1958).

34 NEB. REV. STAT. §77-2008.03.04. (Reissue 1958).

35 INT. REV. CODE. of 1954, §2041.

36 Revenue Act of 1924 § 302(d).

37 INT. REV. CODE of 1954, §2038.

38 LOWNDES & KRAMER, FEDERAL ESTATE & GIFT TAXES 174 (2d ed. 1962).

mately entitled to the property in any event is a sufficient power to terminate, bringing the property back into the transferor's estate for estate tax purposes.[39]

The United States Supreme Court in 1929 decided *Reinecke v. Northern Trust Co.*[40] and held that a trust in which the settlor retained the income for his life and the power to revoke was subject to tax under the federal statute as a transfer taking effect in possession or enjoyment at or after death. Although the present statute originally enacted in 1924 was on the books, it was inapplicable to the *Reinecke* facts, which arose prior to 1924. Thus, the decision supports the taxation of revocable transfers under the similar Nebraska provisions taxing transfers intended to take effect in possession or enjoyment after death. The opposite result has been reached under some state statutes similar to that of Nebraska.[41]

By specific language of the present federal statute, a power is taxable even if exercisable only in conjunction with an adverse party.[42] As the Nebraska statute has no such specific language, it would probably not be construed to include such a transfer.

If the Nebraska statute includes a beneficial power, it could by the same reasoning include nonbeneficial retained powers. One can agrue that the retention of a nonbeneficial power such as the ability to change the beneficiaries of a trust but not name himself beneficiary makes the enjoyment or possession of the property subject to change so that death extinguishes the power and makes possession or enjoyment certain. For the purposes of wealth transmission and taxes arising therefrom, however, there should be a distinction between the possession of a power of appointment obtained through a transfer by a third person and control retained by the decedent whose estate is being taxed.

It would seem under the above situations involving retained powers that the amount taxable would be the value of the property subject to the power. The amount would be that property which was transferred to take effect in possession or enjoyment after death, as that would be the value of the property subject to a shift in enjoyment. This is to be distinguished from the value of the

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[39] Lober v. United States, 108 F. Supp. 731 (Ct.Cl. 1952), *aff'd* 346 U.S. 335 (1953).

[40] 278 U.S. 339 (1929).

[41] See Rottschaeffer, *Taxation of Transfers Taking Effect in Possession at Grantor's Death,* 26 IOWA L. REV. 514, 531 (1941).

[42] INT. REV. CODE of 1954, §2038.

power itself. The value of the power, its worth to the holder merely as a power, would be includable within a decendent's estate under the general Nebraska Inheritance Tax provision.[43] It is when the power is retained that the value of the property subject to the power is includable under section 77-2002.[44]

V. REQUIREMENT THAT DECEDENT MAKE A "TRANSFER"

For the property to be included within the decendent's estate for Nebraska inheritance purposes, the decedent must have in fact made a "transfer" of the property.[45] In *County of Holt v. Gallagher*,[46] the Nebraska Supreme Court refused to include in the decedent's estate an executory interest which the settlor, the decedent's brother, had provided for him in a trust instrument. The settlor had provided that the trust income and whatever principal was necessary be used to provide for his daughter's maintenance after his death. At the death of the daughter, the remaining principal and undistributed income was to be distributed to the decedent or his heirs, legal representatives or assigns. Decedent predeceased the daughter. As the decedent did not make the transfer in question, he had no interest in the property subject to an inheritance tax. Such a requirement that the decedent make the "transfer" is essential because of the policy behind the possession or enjoyment section preventing the avoidance of the inheritance tax by inter vivos transfers of a testamentary character.

Thus it is essential to determine who is the transferor for inheritance tax purposes.[47] Where A created a trust while B in consideration therefor created a similar trust for A, each should be considered the transferor of the trust which provides him with a life interest. Substance rather than form should control to prevent

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[43] NEB. REV. STAT. §77-2001 (Reissue 1958).

[44] NEB. REV. STAT. § 77-2002 (Reissue 1958).

[45] *Id.* The requirement erroneously appears to apply only to subsection (a). In order for the wording to make sense (a) must be read as beginning "made in contemplation of death." In this way the statute would require: "Any interest in property . . . shall be subject to tax . . . if it shall be transferred by deed, grant, sale, or gift, in trust or otherwise: (a) made in contemplation at the death of the grantor; (b) intended to take effect in possession or enjoyment after his death; (c) by reason of death, any person shall become beneficially entitled. . . ; (d) held as joint tenants. . . ."

[46] 156 Neb. 457, 56 N.W.2d 621 (1953).

[47] LOWNDES & KRAMER, FEDERAL ESTATE & GIFT TAXES 191 (2d ed. 1962).

the avoidance of an inheritance tax rightfully due. Such a doctrine has been applied to reciprocal transfers under the federal statute,[48] and the same result should be reached in Nebraska.

VI. CONCLUSION

The scope of the Nebraska inheritance tax provisions defining the property interests subject to taxation is largely undetermined. The federal estate tax provisions, the subject of more extensive judicial construction, have evolved from substantially the same initial framework. To the extent that the federal decisions and subsequent legislative revisions have dealt with analogous issues, they provide at least a workable starting point in analyzing the Nebraska statutes and in pointing up hazards to the estate planner and precedent for lawyers and judges. Furthermore, the federal statutes as they exist today demonstrate legislative responses to estate planning and judicial developments over a substantial period of time which could be significant in evaluating not only the meaning but also the soundness of the Nebraska law.

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[48] Lehman v. Comm'r, 109 F.2d 99 (2d Cir. 1940), *cert. denied,* 310 U.S. 637 (1940); Cole's Estate v. Comm'r, 140 F.2d 636 (8th Cir. 1944).